No. 16534

In the United States Court of Appeals for the Ninth Circuit

TIME OIL CO., a corporation, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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CITATIONS

Miscellaneous—Continued

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PREVIOUS OPINIONS

The Tax Court's former opinion in this case is reported at 26 T.C. 1061. Upon review, this Court remanded, 258 F. 2d 237. The decision of the Tax Court on the remand (R. 21-22) is not officially reported.

JURISDICTION

This case concerns federal income taxes for the years 1949 and 1950 and was previously before this Court (Docket No. 15444), which remanded it to the Tax Court for further proceedings (258 F. 2d

237). The decision of the Tax Court on the remand was entered on April 7, 1959. (R. 21-22.) The case is brought again to this Court by a petition for review filed May 4, 1959. (R. 23-30.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in holding on the remand from this Court that contributions made to a stock bonus and profit sharing trust by promissory note within sixty days after the close of a taxable year by an accrual basis taxpayer must be deducted in the taxable year.

STATUTE AND OTHER AUTHORITIES INVOLVED

The pertinent portions are set forth in the Appendix, *infra.*

STATEMENT

This case is now before this Court for the second time. It was originally the position of the Commissioner in the Tax Court that the Time Oil Company, the taxpayer herein, was not entitled to deductions in 1949 and 1950 for contributions to a stock bonus and profit sharing trust for its employees on the ground that the trust was not tax exempt because of various discrepancies between the plan as submitted to the Commissioner and its actual operation. Upon review, this Court held that since the trust plan had previously been approved by the Commissioner and since the variations between the approved plan and the actual operation of it were *de minimus*, the trust

was tax exempt for the years in question and the taxpayer accordingly was entitled to deduct under the provisions of Section 23(p) of the Internal Revenue Code of 1939 the amounts contributed thereto. In addition, the Commissioner contended that where the taxpayer made its contributions to the stock bonus and profit sharing trust by the issuance of negotiable notes, such contributions might not be deducted until the year in which the note was discharged. This Court held to the contrary (258 F. 2d 237, 240), stating that "delivery of the notes to the trustee constituted payment by Time Oil Company as of the delivery date. This would determine the year of deductibility." The case was thereupon remanded to the Tax Court for a determination of the "amounts allowable as deductions under permissible limits of the statute."

The taxpayer was on an accrual basis. (No. 15444, R. 25-26.) There are four separate notes involved in this case. Information concerning these notes is tabulated below:

	NOTES ISSUED			
	$30,466.86	$66,342.82	$84,568.49	$25,067.9
Contribution for year ended (No. 15444, R. 67)	1947	1948	1949	194
Date of delivery to trustee (No. 15444, R. 67)	May, 1948	2-28-49	2-15-50	4-17-5
Date of discharge of note (No. 15444, R. 67)	4-20-49	8-8-50	8-8-50[2]	?
Year in which taxpayer claims deduction (Br. 5; R. 13-16)	1949	1949	1950	195
Year of deduction as computed by Commissioner (R. 11)	1948	1948-1949[1]	1949-1950[3]	195

The Tax Court entered judgment in accord with the Commissioner's computations (R. 21-22) and from such decision the taxpayer here petitions for review (R. 23-30).

SUMMARY OF ARGUMENT

On the remand, this case involves no more than the question of the year of deductibility of contributions to a profit-sharing trust. This Court has held that such contributions were "paid" when the tax-

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[1] The Commissioner computed that $42,347.54 was deductible in 1948 and that the balance, $23,995.28, could be carried over as a deduction in 1949. (R. 11.)

[2] A partial discharge only, in the amount of $21,926.45, was made of this note. (No. 15444, R. 67.)

[3] The Commissioner computed that $51,562.31 was deductible in 1949 and that $33,006.18 could be carried over as a deduction in 1950. (R. 11.)

payer delivered its promissory notes. The computations of the Commissioner on the remand, which were accepted by the Tax Court for entry of judgment, were based upon two premises. The first was that where a note was issued by an accrual basis taxpayer within sixty days after the close of a taxable year, the note must be deducted during the taxable year under the mandatory language of Section 23(p)(1)(E) of the 1939 Code. The second premise is that the only relevant date for determination of deductibility is the date of *delivery* of the note. The language of this Court in its opinion on the earlier appeal in this case, in which it was stated that the deductions can be calculated for the years in which the notes were "discharged", appears to be inadvertent and probably resulted from a clerical error. From the language immediately preceding the statement in question it is clear that the Court meant to say "delivered"; indeed to hold otherwise would set up a conflict with the Third Circuit, which this Court expressly refused to do. The decision of the Tax Court is correct and should be affirmed.

ARGUMENT

Where Contributions Are Made To A Stock Bonus and Profit-Sharing Trust By Promissory Note Within Sixty Days After the Close of A Taxable Year By An Accrual Basis Taxpayer, the Contributions Must Be Deducted in the Taxable Year

The taxpayer herein made various contributions to a stock bonus and profit-sharing trust which it had set up for its employees. This Court held that the trust was tax exempt under Section 165 of the In-

ternal Revenue Code of 1939, and that the taxpayer's contributions thereto were deductible under Section 23(p)(1)(C), Appendix, *infra*. It also held that the issuance of promissory notes to the trustee constituted payment within the statutory language, whereas the Commissioner had contended that there was no payment until the taxpayer discharged the promissory notes. 258 F. 2d 237. The present aspect of this case concerns the year in which deduction for the various payments by promissory note may be taken, the taxpayer objecting to the Tax Court decision upon the remand which accepted the Commissioner's computations as a basis for entry of decision.

Contributions to stock bonus and profit-sharing plans are deductible when paid to the extent of fifteen percent of the compensation otherwise paid or accrued during the taxable years to all employees under the stock bonus or profit-sharing plan (Section 23(p)(1)(C)), except that Section 23(p)(1)(E), Appendix, *infra*, provides that—

> (E) For the purposes of subparagraphs (A), (B), and (C), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year, and is made within sixty days after the close of the taxable year of accrual.

In addition, the statutory scheme provides that if there is paid an amount less than the fifteen percent limitation, the taxpayer shall have a credit for the difference which may be carried forward and de-

ducted in succeeding taxable years, subject again to the fifteen percent limitation in the succeeding year; likewise, if there is paid an amount in excess of fifteen percent, the excess amount contributed may likewise be deducted in succeeding taxable years, with the fifteen percent limitation. Section 23(p)(1)(C). The fifteen percent limitation is not in controversy in this case, the only question being the basic year of deductibility of each note.

The Commissioner's computations were based upon two premises. The first is that, where a note was issued within sixty days after the close of a taxable year, the note must be deducted in the taxable year to the extent allowed under the fifteen percent limitation. This is so because the language of Section 23(p)(1)(E) in mandatory terms provides that "a taxpayer on the accrual basis *shall* be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year, and is made within sixty days after the close of the taxable year of accrual." (Italics supplied.) The statute does not provide that an accrual basis taxpayer may or may not, as it wishes, make a choice as to the year of deductibility, as the taxpayer here contends. There is nothing whatsoever permissive about the terms of the section. As a general rule, a liability must be accrued for tax purposes when an unconditional obligation to pay arises. This general rule is then somewhat restricted by the specific provisions of the Code relating to stock bonus, pension, profit-sharing or annuity plans, wherein only contributions "paid" rather than those paid or accrued

are to be deductible. To some extent it was the intent of Congress to place all taxpayers on an equal footing, regardless of whether they report income on the accrual basis or the cash basis of accounting. See H. Rep. No. 2087, 80th Cong., 2d Sess., p. 13, on Revenue Revision Act of 1948. However, it was not intended to remove completely all accruals under Section 23(p) of the Code by an accrual basis taxpayer. For that reason, Section 23(p)(1)(E) was enacted to retain the accrual system of reporting to a limited extent. Thus, the liability for contributions to a profit-sharing plan must be accrued if there was an unconditional liability to pay and if actual payment was made within sixty days of the close of the taxable year. See also 4 Mertens, Law of Federal Income Taxation, Secs. 25B.28 and 25B.29; Rev. Rul. 56-366, 1956-2 Cum. Bull. 976, Appendix, *infra;* Rev. Rul. 57-378, 1957-2 Cum. Bull. 268, Appendix, *infra.*

The second premise upon which the Commissioner's computations were based is that the only relevant date in this case for determination of the basic year of deductibility is the date of *delivery* of the note under the decision of this Court. In adopting the view of the Third Circuit in *Sachs* v. *Commissioner*, 208 F. 2d 313, this Court, although recognizing that the point was "a close one", specifically held (258 F. 2d 237, 240) that "delivery of the notes to the trustee constituted payment by Time Oil Company as of the delivery date".

The Commissioner has therefore made his computations on the theory that the basic year of deducti-

bility of any of the notes involved may be determined only by applying the above two tests. Thus, taking each note in turn, it can readily be seen that the Commissioner has followed a consistent and logical method of determining the year of deductibility which is squarely in accord with the language which this Court used in remanding the matter to the Tax Court. On the other hand, the taxpayer has vacillated from one theory to another depending upon the particular tax consequences befalling it as to the deductible year of any given note. This is readily apparent when the contentions as to the deductibility of each note are reviewed seriatim.[4]

The first note in issue, that for $30,466.86, was issued in May of 1948. Since this Court has held that issuance constitutes payment in this case, it is our position that under the remand the note was be deducted in 1948. The taxpayer, on the other hand, argues that it should be allowed to deduct the note in 1949, when it was discharged, rather than in 1948, when it was issued. Its reasoning in this respect, while interesting, is not persuasive. Apparently, the taxpayer bases its argument as to this note upon the fact that the Commissioner originally denied taxpayer a deduction of the $30,466.86 for

[4] The taxpayer's arguments as to this question are completely inconsistent. Thus, it argues that the first note should be deducted in 1949, the year of discharge; the second note in 1949, during the first sixty days of which year the note was issued; the third note in 1950, where the note was issued in February of that year and paid in August; the fourth note in 1950, during April of which the note was issued.

the year 1947, and that taxpayer thereafter signed a "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax" [5] for that year. (Br. 3-4; No. 15444, R. 28-29.) Just why this action upon the part of the Commissioner and the taxpayer should now give taxpayer the right to the deduction in 1949 is nowhere explained. Under no theory advanced in this case would this amount be deductible in 1947. The note was not issued until May of 1948 and was not paid until April of 1949. (No. 15444, R. 67.) It should be pointed out that the Commissioner consistently argued before the Tax Court and this Court that the notes should not be deductible until they were actually paid; it was the taxpayer itself which first brought up this issue by its argument that the notes should be deductible when issued.[6] Now, having convinced this Court to refrain from a conflict with the Third Circuit in this respect and to hold that issuance of the note is payment, the taxpayer has apparently changed its mind. But on the re-

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[5] The taxpayer argues that because it has signed a waiver for 1947 and 1948 taxes the Commissioner should be estopped from denying it the deduction for 1949. (Br. 8-10.) Even if it should be true that 1948 is a barred year, as taxpayer now contends, it is still not entitled to the deductions it seeks for the years before this Court. We would suggest that taxpayer's remedy, if indeed it has any, must lie within the provisions of Sections 1311 through 1315 of the 1954 Code, which in some situations mitigate the effect of the statute of limitations.

[6] Obviously, if taxpayer had not brought up the point the question would never have been at issue since the Commissioner has always contended that the issuance of the notes did not constitute payment.

mand the Tax Court was bound to follow this Court's decision. Accordingly, the Tax Court correctly held that the $30,466.86 note is deductible only in 1948, when it was issued.

The inconsistent position now adopted by the taxpayer evidently stems from the next to the last paragraph of this Court's opinion. (Br. 7-8.) This Court stated that—

> It would appear that under the principles laid down the allowable deductions can be readily calculated by the tax court for the years in which the note obligations were *discharged.* (Italics supplied.)

A reading of the entire opinion makes it clear that most likely the use of the word "discharged" by this Court was inadvertent and probably the result of a clerical error. From the language immediately preceding this sentence we believe that there is no doubt but that the Court meant "delivered". Indeed, the language preceding the above-quoted language makes it clear that the law of this case is that notes are deductible when issued. To hold otherwise would set up a conflict between this Court and the Third Circuit in the *Sachs* case and this Court expressly stated that it would not set up such a conflict. The note for $30,466.86 must be deducted in the year in which it was delivered, 1948, rather than the year in which it was discharged, 1949, under the mandate of this Court.

The next note to be considered is that for $66,-342.82. This note was delivered to the trustee on February 28, 1949. It was paid on August 8, 1950.

(No. 15444, R. 67.) The taxpayer claims that this note also should be deducted in the year 1949. (Br. 5.) It is our position, however, that since this note was delivered by an accrual basis taxpayer less than sixty days from the end of the taxable year (1948) to which it related, Section 23(p)(1)(E) requires that it be deducted in the taxable year, 1948. Since, however, the total allowable deductions in 1948 exceeded the fifteen percent limitation set up by the statute, the difference has been carried over into 1949 in the computations. Thus, $23,995.28 of the total amount of this note is deductible in 1949. The taxpayer places in issue only the fact that the Commissioner has not allowed the entire amount to be deducted in 1949. (Br. 4.)

Under the argument of the taxpayer regarding the deductibility of the note for $30,466.86, great reliance is placed upon what we feel to be the inadvertent statement of this Court that the deductions could be taken in the year in which the notes were discharged. In regard to the $66,342.82 note issued for the succeeding year's contributions, however, the taxpayer makes a new, inconsistent, and completely different argument. Here, rather than placing reliance upon the use of the word "discharged" and arguing that the note should be deducted in 1950 when it was discharged, taxpayer argues that it should be deducted in 1949 since it was actually issued during that calendar year. To reach this conclusion, once again the taxpayer would have this Court completely ignore the mandatory language of Section 23(p)(1)(E) that such payment within

sixty days of the taxable year "shall" be deemed to have been made during the taxable year, which in this case was 1948.

As to the remaining two notes involved in this case, the taxpayer apparently is in agreement with the computation of the Commissioner. In any event it limits this appeal to the first two notes. However, for the information of this Court, the note for $84,-568.49 was issued in February of 1950 and partially discharged in August of 1950. (No. 15444, R. 67.) The Commissioner, following the mandatory language of Section 23(p)(1)(E), considered the basic year of deductibility of this note as 1949. Here, too, there was some carry over into 1950 because of the fifteen percent limitation. (R. 11.) The last note, that for $25,067.96, was issued on April 17, 1950. (No. 15444, R. 67.) The record apparently does not show its date of discharge. Under the Commissioner's computations this note was deductible in 1950. (R. 11.) Thus once again the taxpayer's position is inconsistent with that advanced in its brief. Indeed, a fair statement as to the taxpayer's choice of a year of deductibility of each note is that it desires the note deducted in whichever year it can receive the best tax advantage. This position the taxpayer maintains despite the clear command of the statute and despite the principles set forth by this Court in remanding the case.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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DECEMBER, 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(p) [As amended by Sec. 162(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan.*—

(1) *General rule.*—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under this subsection but only to the following extent:

* * * *

(C) In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 165(a), in an amount not in excess of 15 per centum of the compensation otherwise paid or accrued during the taxable year to all

employees under the stock bonus or profit-sharing plan. If in any taxable year beginning after December 31, 1941, there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 per centum of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in a taxable year beginning after December 31, 1941, in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 per centum of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust", as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering

a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarily as provided in subparagraph (A). If the contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

* * * *

(E) For the purposes of subparagraphs (A), (B), and (C), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year of accrual.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(p)-1. *Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred Payment Plan —In General.*— * * *

* * * *

Deductions under section 23(p) are generally allowable only for the year for which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his return on the accrual basis. Exceptions are made in the case of overpayments as provided in subparagraphs (A), (C), and (F) of section 23

(p)(1), and, as provided by section 23(p)(1)(E), in the case of payments made by a taxpayer on the accrual basis within 60 days after the close of the taxable year of accrual. This latter provision is intended to permit a taxpayer on the accrual basis to deduct such accrued contribution or compensation, provided payment is actually made within 60 days after the close of the year of accrual.

* * * *

SEC. 29.23(p)-10 [As amended by T.D. 5666, 1948-2 Cum. Bull. 34]. *Contributions of an Employer to an Employees' Profit-Sharing or Stock Bonus Trust That Meets the Requirements of Section 165(a)—Application of Section 23(p)(1)(C).*— * * *

The amount of deductions under section 23(p)(1)(C) for any taxable year is subject to limitations based on the compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan. For this purpose "compensation otherwise paid or accrued" means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165(a), including a plan that qualifies under section 23(p)(1)(B). The limitations under section 23(p)(1)(C) apply to the total amount deductible for contributions to the trust regardless of how the funds of the trust are invested, applied, or distributed, and no other deduction is allowable on account of any benefits provided by contributions to the trust or by the funds thereof. Where contributions are paid to two or more profit-sharing or stock

bonus trusts satisfying the conditions for deduction under section 23(p)(1)(C), such trusts are considered as a single trust in applying these limitations.

The primary limitation on deductions for a taxable year is 15 percent of the compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan. So long as the contributions do not in any year exceed the primary limitation, this is the only limitation under section 23(p)(1)(C) which has any effect.

In order that the deductions may average 15 percent of compensation otherwise paid or accrued over a period of years where contributions in some taxable year beginning after December 31, 1941, are less than the primary limitation but contributions in some succeeding taxable year exceed the primary limitation, deductions in each succeeding year are subject to a secondary limitation instead of to the primary limitation. The secondary limitation for any year is equal to the lesser of (a) twice the primary limitation for the year, or (b) any excess of (1) the aggregate of the primary limitations for the year and for all prior years beginning after December 31, 1941, over (2) the aggregate of the deductions allowed or allowable under the limitations provided in section 23(p)(1)(C) for all prior years beginning after December 31, 1941, after giving effect to the provisions of section 162(d)(1)(C) of the Revenue Act of 1942 in computing both items (1) and (2).

In any case where the contributions in a taxable year beginning after December 31, 1941,

exceed the amount allowable as a deduction for the year under section 23(p)(1)(C) after giving effect to section 162(d)(1)(C) of the Revenue Act of 1942, the excess is deductible in succeeding taxable years, in order of time, in which the contributions are less than the primary limitations, so that the total deduction for any such succeeding year is equal to the primary limitation for such year but not more than the sum of the contributions in such year and the excess contributions not deducted under the limitations of section 23(p)(1)(C) for prior years beginning after December 31, 1941.

* * * *

Rev. Rul. 56-366, 1956-2 Cum. Bull. 976:

REGULATIONS 118, SECTION 39.23(p)-10: Contributions of an employer to an employees' profit-sharing or stock bonus trust that meets the requirements of section 165(a).

(Also Regulations 111, Section 29.23(p)-10.)

An employees' profit-sharing or stock bonus plan which is intended to qualify under section 165(a) of the Internal Revenue Code of 1939 is not required to contain a definite predetermined formula for determining the profits to be shared as a condition for qualification. If a plan contains such a formula, however, contributions in excess of the formula commitment must be made pursuant to a legal obligation incurred prior to the close of the taxable year under consideration.

I. T. 4055, C. B. 1951-2, 30, modified.

Advice has been requested whether it is permissible to ignore a definite predetermined formula for determining the profits to be shared, presently contained in an existing employees' profit-sharing or stock bonus plan which is qualified under section 165(a) of the Internal Revenue Code of 1939, and make contributions in any amounts desired and obtain deductions therefor within the applicable limits, in view of the definition of a profit-sharing plan set forth in section 39.165-1(a)(2) of Regulations 118 and section 29.165-1(a) of Regulations 111, both as last amended by T. D. 6189, page 972 of this Bulletin, approved July 2, 1956, which omits the requirement for such a definite predetermined formula, contained in the regulations prior to the last amendment.

Deductions under section 23(p) of the Code are generally allowable only in the taxable year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his return on the accrual basis, except that overpayments may be carried forward as provided for in subparagraphs (A), (C), and (F) of section 23(p)(1) of the Code, and, as provided by section 23(p)(1)(E) of the Code, a taxpayer on the accrual basis may make payment within 60 days after the close of the taxable year of accrual. The provision for payment after the close of the taxable year of accrual, however, is not applicable unless, during the taxable year on account of which the contribution is made, the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 43 of the Code for such taxable year.

Accordingly, the contribution must either be made during the taxable year under consideration, or, in the case of a taxpayer on the accrual basis who makes a contribution within 60 days after the close of the taxable year of accrual, the taxpayer must incur a liability to make the contribution, the amount of which is accruable under section 43 of the Code for such taxable year. If the plan is amended prior to the close of the taxable year, such liability will be incurred in accordance with the amendment. The amendment need not be executed with any degree of formality but, as prescribed by section 39.165-1 (a)(1) of Regulations 118, it must conform to the following requisites:

1. It must be in writing. In this respect, it must be signed by persons competent to bind the parties before the close of the taxable year under consideration.

2. It must be definite so as to constitute part of the definite written program and arrangement which is the plan.

3. It must be communicated to the employees. This must be done before the contribution is made and before the close of the taxable year under consideration.

4. It must be part of the plan which has been established and is maintained by the employer.

I. T. 4055, C. B. 1951-3, 30, holds that deductions for contributions to an employees' qualified profit-sharing trust are allowable under the conditions and within the limitations of section 23(p)(1)(C) of the Code only to the extent required by the terms of the plan of which the

trust is a part, and that payments in excess of the required amounts are not available as carryovers and are not deductible in a subsequent year. To the extent that I. T. 4055 limits the allowable deduction for contributions by a predetermined formula for determining profits to be shared, it is hereby modified.

Rev. Rul. 57-378, 1957-2 Cum. Bull. 268:

26 CFR 1.404(a)-9: Contributions of an employer to an employees' profit-sharing or stock bonus trust that meets the requirements of section 401(a); application of section 404(a)(3)(A).

When an employer's commitment under a qualified employees' profit-sharing plan, for a particular taxable year, is made subsequent to the time within which an accrual method taxpayer may make a contribution which will be allowable as a deduction for such taxable year, no deduction is allowable for such year but the employer is entitled to a "credit carryover" for the year or years in which the commitment is paid. If the contributions paid, in such subsequent year, do not exceed the primary limitation of fifteen percent of compensation of participants then the "credit carryover" is not applicable. If such contributions do exceed such primary limitation, then to the extent that they do not exceed the lesser of (a) thirty percent of compensation of participating employees for such year, or (b), the primary limitation of fifteen percent plus the "credit carryover" from prior years, they are deductible.

Advice has been requested concerning the deductibility of contributions made by an employer to a qualified employees' profit-sharing plan when the payment required for a particular taxable year is made subsequent to the time prescribed by section 404(a)(6) of the Internal Revenue Code of 1954.

Under the provisions of a certain qualified employees' profit-sharing plan, the employer corporation is committed to make an annual contribution equal to the lesser of ten percent of corporate profits or fifteen percent of compensation of participating employees. For the year 1954, ten percent of corporate profits equalled $10,000 while fifteen percent of compensation of participating employees equaled $20,000. The contribution of $10,000 thus required for the year 1954, however, was not made until a few days after the expiration of the time within which an accrual basis taxpayer may make a contribution to an employees' trust which will be allowable as a deduction for the prior taxable year.

For the taxable year 1955, a contribution of $15,000 was required of the employer since ten percent of corporate profits equalled $15,000 while fifteen percent of compensation of participating employees equaled $20,000. The $15,000 contribution for 1955 was timely made. Thus, a total of $25,000 was paid into the profit-sharing trust by the employer within the taxable year 1955. No carryovers of any kind exist from years prior to 1954.

Section 404(a) of the Code provides in part that, if contributions are paid by an employer to or under a profit-sharing plan, such contribu-

tions, in order to be deductible, must be expenses which would be deductible under section 162 of the Code, relating to trade or business expenses, or section 212, relating to expenses for production of income, if it were not for the provision in section 404(a) that they are deductible, if at all, only under section 404(a) of the Code. Section 404(a)(3)(A) sets forth the limitations on deductible contributions to profit-sharing trusts. That section provides that contributions shall be deductible in the taxable year when paid, in an amount not in excess of fifteen percent of the compensation otherwise paid or accrued during the taxable year to all employees under the profit-sharing plan. If in any taxable year there is paid into the trust amounts less than fifteen percent of compensation of participating employees, the excess, or if no amount is paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this limitation in any such succeeding taxable year shall not exceed fifteen percent of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan.

Pertinent parts of section 1.404(a)-9 of the Income Tax Regulations state that the primary limitation on deductions for a taxable year is fifteen percent of the compensation otherwise paid or accrued during such taxable year to the employees who, in such year, are beneficiaries of the trust funds accumulated under the plan. So long as the contributions do not in any year exceed the primary limitation, this is the only limitation under section 404(a)(3)(A) which

has any effect. In order that the deductions may average fifteen percent of compensation otherwise paid or accrued over a period of years, where contributions in some taxable year are less than the primary limitation but contributions in some succeeding taxable year exceed the primary limitation, deductions in each succeeding year are subject to a secondary limitation instead of to the primary limitation. The secondary limitation for any year is equal to the lesser of (1) twice the primary limitation for the year of (2) any excess of (a) the aggregate of the primary limitations for the year and for all prior years over (b) the aggregate of the deductions allowed or allowable under the limitations provided in section 404(a)(3)(A) for all prior years.

Under the provisions of section 404(a)(6) of the Code, a taxpayer on the accrual basis is deemed to have made a payment, to a profit-sharing trust created or organized within the United States, on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year, including extensions thereof.

To the extent an employer commits itself to make contributions to a profit-sharing plan in effect on the last day of a particular taxable year, the amount of the contribution required accrues as at the end of such year. But for the requirement of section 404(a) of the Code that the contribution be paid in order to be allowed as a deduction, the entire amount of the contribution would be deductible for the year of accrual to the extent it represents an ordinary and

necessary business expense and constitutes reasonable compensation for services rendered. This is true whether the contribution is paid in the year of accrual or some subsequent year.

The requirements of section 404(a) have the effect of (1) deferring a deduction of the accrued contribution until the taxable year when paid and (2) limiting the amount of the deduction to the percentage set forth therein for a particuar taxable year. In applying the limitations, contributions not in excess of the plan's commitments, for the current or any prior year, need not be identified. Thus, if contributions required for the year 1954 are paid within the taxable year 1954, including the period provided by section 404(a)(6), they represent amounts deductible, subject to the limitations of section 404(a)(3)(A) of the Code. If the contributions do not exceed the fifteen percent primary limitation provided therein, then the so-called "credit carryover" is not applicable. On the other hand, if such contributions do exceed such primary limitation, then, to the extent that they do not exceed the lesser of (a) thirty percent of compensation of participating employees for such year, or (b) the primary limitation of fifteen percent plus the "credit carryover" from prior years, they are deductible. The "credit carryover" referred to in the secondary limitation in the preceding sentence is the term generally used to refer to the excess of the aggregate of the primary limitations for the year and for all prior years over the aggregate of the deductions allowed or allowable under the limitations provided in section 404(a)(3)(A) for all prior

years, referred to in section 1.404(a)-9(d) of the Income Tax Regulations. See Mimeograph 6131, C. B. 1947-1,21.

The application of the principles set forth above, as applied to the facts stated herein, is illustrated in the following tabulation (figures represent thousands of dollars):

Year	Commitment under the plan	Contributions paid	Primary limitation, 15 percent of compensation	Credit carryover	Amount deductible
1954	10	None	20	20	[1] None
1955	15	25	20	[2] (5)	25
Totals	25	25	40	15	25

[1] See Rev. Rul. 56-674, C.B. 1956-2, 293.

[2] $5,000 of the credit carryover from 1954 is being used in 1955, leaving a net carryover at the end of 1955 of $15,000.

Note: On the last day of each year, the amounts required under the plan for that year accrued and remained an obligation of the employer until paid or contributed: therefore, to the extent the commitment was paid, it was deductible in the year of payment within the limitations of section 404(a)(3)(A). Since the $25,000 contributions, paid in 1955, exceeded the primary limitation of fifteen percent of compensation of participants, it became necessary to determine the amount of the secondary limitation. As the secondary limitation (the lesser of thirty percent of compensation for the year 1955, which equals $40,000, or fifteen percent of such compensation plus the "credit carryover" of $20,000 from 1954, which equals $40,000) exceeded the amount paid in 1955, the entire contribution of $25,000 is deductible for that year.